

KELLY OIL CO.
v.
ACTING DEPUTY ASSISTANT SECRETARY--INDIAN AFFAIRS (OPERATIONS)

IBIA 86-6-A

Decided August 5, 1987

Appeal from a decision of the Acting Deputy Assistant Secretary--Indian Affairs (Operations) increasing the rent on lease No. 1-0454 for a portion of Yakima Allotment Nos. 1136 and T-1136.

Affirmed as modified; recommended decision adopted in part and rejected in part.

1. Appraisals--Indians: Leases and Permits: Rental Rates

A rental adjustment to a lease of Indian land, which is based on an appraisal employing a sales price comparison methodology, will be affirmed if it is reasonable, that is, if it is supported in law and by substantial evidence.

APPEARANCES: Shelby Blevins, Walla Walla, Washington, for appellant; Colleen Kelley, Esq., Office of the Solicitor, U.S. Department of the Interior, Portland, Oregon, for appellee.

OPINION BY ACTING CHIEF ADMINISTRATIVE JUDGE VOGT

On October 8, 1986, the Board dismissed this appeal in part and referred the remaining part to the Hearings Division of this office for an evidentiary hearing and recommended decision by an Administrative Law Judge (Departmental). Kelly Oil Co. v. Acting Deputy Assistant Secretary--Indian Affairs (Operations), 15 IBIA 5 (1986). 1/ The Board found that it was unable to determine from the record before it whether an October 7, 1983, rental adjustment to a business lease, No. 1-0454, for a portion of Yakima Allotment Nos. 1136 and T-1136, was reasonable because of the incomplete evidence supporting the Bureau of Indian Affairs' (BIA's) choice of appraisal methodologies, calculations based on sales of fee simple properties, and calculations based on cents-per-gallon of gasoline sold. 2/ The Board directed the Administrative Law Judge to consider whether there was

1/ See this decision for a discussion of the background of this matter.

2/ The leased property was used for a service station.

substantial evidence supporting BIA's choice of the sales price comparison and cents-per-gallon appraisal methodologies, its valuation of the comparables, and its use of 1-1/2 cents as the appropriate cents-per-gallon rate. The Board also requested the Administrative Law Judge to consider whether the cents-per-gallon appraisal methodology was appropriately applied to this lease, which had been negotiated for a flat rate rental rather than a percentage-of-income rental. 15 IBIA at 11.

The case was referred to Administrative Law Judge Michael L. Morehouse, who held a hearing on December 9, 1986. Witnesses at the hearing were Dennis Kohler, the BIA appraiser who prepared the appraisal for the rental adjustment at issue; Shelby Blevins and Kathryn Kelly, the general manager and the president of appellant; and Al Harrison, a commercial investment manager and associate broker, who testified on behalf of appellant.

Judge Morehouse issued a recommended decision on May 27, 1987. He concluded that BIA's decision to increase the rent some 67 percent on the basis of sales price comparisons was not reasonable when commercial real estate prices in the general area had increased no more than 18 percent since the lease was entered in 1979. He stated that there was also a question whether the comparables used could be related closely to the value of the subject property. He further concluded that BIA's alternate cents-per-gallon appraisal methodology was not proper because there was no indication that the consideration for the lease was based on percentages of income produced by the land. He found that a 9 percent increase was fair and equitable and would take into account a market increase in 1979 and 1980 and allow for the beginning of a downturn in the market in 1982 and 1983. He recommended therefore that the rent be increased 9 percent beginning in 1984.

Judge Morehouse's recommended decision was mailed to some of the parties on May 27, 1987, and to the remaining parties on June 5, 1987. Pursuant to 43 CFR 4.339, all parties were given the opportunity to file exceptions to the recommended decision within 30 days of receipt of the decision.

Appellee filed exceptions, which were received by the Board on June 29, 1987.

Discussion and Conclusions

Appellee takes exception to Judge Morehouse's conclusion that use of the sales price comparison methodology was unreasonable and to his statement that there was a question whether the comparables used were really related closely to the value of the subject property.

Appellee argues that the Judge erred in basing his recommended rental adjustment on a time adjustment factor alone, *i.e.*, the change in sales prices for commercial real estate. She points out that the BIA appraisal analyzed properties similar to the leased property and adjusted the sales prices by several factors, including time, to make them truly comparable

to the leased property. At the hearing, the BIA appraiser stated that he did not consider it to be accepted appraisal practice simply to adjust the rental by the amount of increase in commercial real estate prices (Tr. 35).

Because the Board concludes, as discussed below, that BIA's choice of a sales price comparison appraisal methodology was reasonable, it need not decide whether Judge Morehouse's methodology is acceptable. ^{3/} The Board notes, however, that it has upheld an increase in rental assessed upon the percentage increase in fee simple land values on or near an Indian reservation where the leased property is located. Wooding v. Portland Area Director, 9 IBIA 158 (1982). In that case, BIA calculated the increase by analyzing specific sales of land near the leased property. Here, the percentage increase in sales prices relied upon by Judge Morehouse, while apparently a generally accepted figure for the Yakima County area, is neither specific to the vicinity of the leased property nor based on a study of properties comparable to the leased property. Absent more evidence that the general increase is appropriately applied, without refinement, to the leased property, the Board would hesitate to uphold this methodology for calculating a rental adjustment.

[1] Appellee argues that BIA's choice of a sales price comparison methodology was reasonable. BIA analyzed sales of six commercial properties similar to the leased property and adjusted the sales prices for time of sale, size, location, and utilities, to arrive at a value of \$60,000 for the property. It then applied a 10 percent rate of return to calculate an annual rental of \$6,000.

The BIA appraisal report, now complete with the addition of page 5, ^{4/} states that the sales price comparison method was chosen because no rentals of property like the leased property were available. The Board has upheld the use of sales data to determine rental value when no comparable rental data is available. Wooding, *supra* at 160. See also Navajo Nation, *supra*, which upheld use of sales data and a rate of return to calculate rental to be paid by the Navajo Nation to the Hopi Tribe for use of Hopi lands.

This case is unlike Wooding in that here the adjustment is based on a single appraisal done in 1983 rather than on a comparison of two sets of appraisal data showing a change in values over a period of time. The Board has, however, upheld use of a single appraisal, employing sales data with a rate of return, to support a rental increase, Snelson v. Acting Deputy Assistant Secretary--Indian Affairs (Operations), 10 IBIA 57 (1982), and

^{3/} As the Board has stated, the Board's role in rental adjustment appeals is to determine whether the adjustment made by BIA is reasonable, that is, whether it is supported in law and by substantial evidence. If it is reasonable, the Board will not substitute its judgment for BIA's. Kelly Oil Co., *supra* at 8; Navajo Nation v. Acting Deputy Assistant Secretary--Indian Affairs (Operations), 15 IBIA 179, 184, 94 I.D. 172, 175 (1987).

^{4/} Page 5 was introduced at the hearing. See 15 IBIA at 10 n.7.

use of a single set of data, in that case a market survey of grazing rates, to support an increase in grazing rental rates. Fort Berthold Land & Livestock Association v. Aberdeen Area Director, 8 IBIA 230, 88 I.D. 315 (1981).

The regulations governing leasing of Indian lands provide that, with certain exceptions, a lease may not be approved or granted at less than the present fair annual rental. 25 CFR 162.5(b). A rental adjustment which adjusts the rent to the fair annual rental at the time of the adjustment takes cognizance of this "fair annual rental" requirement. It also conforms to the provisions of 25 CFR 162.8 concerning rental adjustments, because it takes into account both the equities involved and the economic conditions at the time. 5/

The record contains no indication whether the original rental for the property was set at the fair annual rental. 6/ However, the 1983 appraisal states that it was prepared in order to determine the fair annual rental as of 1983 (Appraisal Report at 5). Although appellant objects to some of the comparables chosen, it does not argue that the sales price comparison methodology employed by BIA was inappropriate for determining fair annual rental. Further, appellant's witness confirmed that the 10 percent rate of return used by BIA was reasonable (Tr. 65).

Therefore, the Board finds that BIA reasonably calculated appellant's rental adjustment through a sales price comparison appraisal methodology, in which sales of comparable properties are analyzed to determine the present fair market value of the property being appraised, and a rate of return is applied to that appraised value.

Judge Morehouse found that BIA's choice of comparables was questionable because two of the properties (Nos. 8084 and 8125) were bought for speculative purposes and produce no income for the buyers, one (No. 7982) was occupied by a restaurant, and one (No. 7983) was the subject of a later default by the purchaser (Recommended Decision at 7).

Certain transactions, such as intra-family sales, may be disqualified as comparables because they are not normal market transactions. 7/ However,

5/ 25 CFR 162.8 provides in relevant part:

"Unless the consideration for the lease is based primarily on percentages of income produced by the land, the lease shall provide for periodic review, at not less than five-year intervals, of the equities involved. Such review shall give consideration to the economic conditions at the time, exclusive of improvement or development required by the contract or the contribution value of such improvements."

6/ The record does not show how the original rental was set. The BIA appraiser testified that there was no earlier appraisal in the file (Tr. 34). None of the witnesses at the hearing were able to state how the rent was determined, although apparently it was proposed by BIA and accepted by appellant without objection (Testimony of Kathryn Kelly, Tr. 94).

7/ See American Institute of Real Estate Appraisers, The Appraisal of Real Estate 315 (8th ed. 1983).

both a person who purchases property for investment purposes, and a person who sells to an investor would be expected to act prudently, knowledgeably, and for self-interest. Thus, a purchase made for investment purposes would meet the criteria for a purchase at market value. 8/ Therefore, Nos. 8084 and 8125 should be considered normal market transactions and, consequently, valid comparables.

The fact that the purchaser of No. 7983 later defaulted does not render the original sale invalid as a comparable. Although appellant apparently believed the default occurred because the price was too high, the BIA appraiser testified that the purchaser was in financial straits (Tr. 55). The events subsequent to the sale do not demonstrate that the sale was not a normal market transaction.

With respect to No. 7982, the property occupied by a restaurant, the record shows that the sale used as a comparable included the land only (Report on No. 7982, attached to Appraisal Report; Testimony of BIA appraiser, Tr. 49). Therefore, the use of the property does not render this sale an invalid comparable.

The Board concludes that appellant has failed to show that BIA's choice of comparables was unreasonable. Further, although appellant has made some general objections to BIA's adjustments to the sales prices, it has failed to show that they were unreasonable. The adjustments are explained on page 5 of the appraisal report and in the BIA appraiser's testimony at the hearing (Tr. 16-20). 9/

Judge Morehouse concluded that the alternative cents-per-gallon appraisal methodology employed by BIA was not reasonable because there was no indication that the consideration for the lease was based primarily on percentages of income produced by the land (Recommended Decision at 6-7). Appellee does not challenge this holding. Therefore, Judge

8/ Market value is defined as:

"The most probable price in cash, terms equivalent to cash, or in other precisely revealed terms, for which the appraised property will sell in a competitive market under all conditions requisite to fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress." Id. at 33.

9/ Page 5 of the appraisal report explains that time adjustments of 9 percent per year were made for sales before Jan. 1, 1981, to account for the increase in sales prices; size adjustments of \$.10 per acre were made because larger parcels are less valuable per acre than smaller parcels; location adjustments were made for proximity to traffic flow because properties on busy streets are more valuable; and adjustments for utilities were made because some of the properties had sewer and water hookups while the leased property did not.

Morehouse's holding on this point is adopted, and the Acting Deputy Assistant Secretary's decision is modified by deletion of the cents-per-gallon methodology as support for the rental adjustment.

The rental adjustment is affirmed on the grounds that it was reasonably based on an appraisal employing a sales price comparison methodology and is supported in law and by substantial evidence in the record.

Therefore, pursuant to the authority delegated to the Board of Indian Appeals by the Secretary of the Interior, 43 CFR 4.1, the September 19, 1985, decision of the Acting Deputy Assistant Secretary--Indian Affairs (Operations) is affirmed as modified.

Anita Vogt
Acting Chief Administrative Judge

I concur:

Kathryn A. Lynn
Administrative Judge